

FINAL STATEMENT OF REASONS
FOR RULE CHANGES UNDER THE
CORPORATE SECURITIES LAW OF 1968

As required by Section 11346.2 of the Government Code, the Commissioner of Corporations ("Commissioner") sets forth below the reasons for the proposed adoption of Sections 260.150.40, 260.204.10 and 260.204.11 of the California Code of Regulations (10 C.C.R. Secs. 260.105.40, 260.204.10 and 260.204.11).

This rulemaking relates to two subjects: (1) Certain Canadian tax-deferred retirement savings accounts, and certain Canadian broker-dealers and agents; and (2) specialists, market makers or floor broker-dealers who are members of the Pacific Exchange, Inc.

Certain Canadian Tax-Deferred Retirement Savings Accounts; Certain Canadian Broker-Dealers and Agents.

On June 23, 2000, the Securities and Exchange Commission (SEC) approved an exemption from registration for Canadian broker-dealers in regard to transactions involving self-administered, tax-advantaged retirement accounts of Canadian residents in the United States. This exemptive relief was granted in tandem with new SEC rules permitting Canadian securities, including mutual funds, to be offered and sold in these self-directed, tax-advantaged retirement plans without the requirement for these securities to be registered under the federal Securities Act of 1933 or the federal Investment Company Act of 1940.

The relief provided under the federal securities laws in regard to these transactions conforms to similar relief already provided by more than 20 states pursuant to a North America Securities Administrators Association (NASAA) resolution in 1995 amending Section 201 of the Uniform Securities Act. The amendment to the Uniform Securities Act would permit a Canadian broker-dealer, subject to a simplified state registration procedure, to deal in the Canadian self-administered, tax-advantaged retirement accounts for Canadian residents in the United States that adopt the NASAA proposal. The simplified registration procedure consists of either a special limited registration or special exemption from registration for Canadian broker-dealers and their sales representatives (i.e., agents) when dealing in Canadian self-directed, tax-advantaged retirement plans.

Accordingly, the Commissioner proposes to adopt two rules exempting from (i) the qualification requirements of Section 25110 of the Corporation Code certain tax-deferred retirement savings accounts and (ii) the certification requirements of Section 25210 for certain Canadian broker-dealers and agents involved in these securities transactions.

Proposed Rule 260.105.40. Consistent with the authority granted to the Commissioner by Section 25105, and in recognition of the federal and other state exemptions, this rule will exempt from the qualification requirements of the Corporate Securities Law of 1968 (the Law) the offer and sale of securities to a "Canadian retirement account" as that term is defined by federal regulations adopted under either the Securities Act of 1933 or the Investment Company Act of 1940. Thus, this exemption

will be consistent with the federal and other state exemptions with respect to securities sold to a Canadian retirement account on behalf of a Canadian resident living in the United States.

Proposed Rule 260.204.10. Although consistent with, and modeled after, Section 201 of the Uniform Securities Act dealing with the limited registration of Canadian broker-dealers and agents, proposed Rule 206.204.10 will exempt completely from the certification (i.e., licensure) requirements of the Law those Canadian broker-dealers and agents effecting transactions in securities in California subject to specified conditions and provisions. It is the Commissioner's view that given the limited nature of the transactions involved (i.e., the offer of sales of securities to a "Canadian Retirement Account") and the Canadian residence of the investors on behalf of whom these transactions are effected, no public policy is served by requiring licensure of Canadian broker-dealers under the Law. The exemption afforded from Section 25210 does not, however, provide an exemption from the other provisions of the law, including the authority of the Commissioner to investigate and examine Canadian broker-dealers and agents, or initiate enforcement actions against them under the Law.

Each of the provisions of proposed Rule 260.204.10 are modeled after the provisions of Section 201 of the Uniform Securities Act, modified (or deleted) where necessary to conform the proposed rule with the intent of an exemption from licensure.

The purpose of Subsection (a) is to limit the effecting of transactions in securities by a Canadian resident who is a temporarily resident in this state and with whom the Canadian broker-dealer has had a bona fide broker-dealer-client relationship before the Canadian resident entered the United States or by a Canadian resident who is also a resident of this state whose securities transactions are in a Canadian Retirement Account of which the resident is the holder or contributor. These provisions are necessary in order to define the scope of the exemption and be consistent with the exemptions and regulatory approach set forth in the SEC rules and Section 201 of the Uniform Securities Act.

Subsection (b) is necessary to limit the activities of an agent representing a Canadian broker-dealer when effecting transactions in securities in reliance on this exemption. Specifically, this subsection provides that the agent may only effect transactions in securities in this state as is permitted for the broker-dealer under subsection (a).

Subsection (c) establishes the requirements for a Canadian broker-dealer effecting transactions under the proposed exemption; specifically the Canadian broker-dealer must be registered and in good standing in the jurisdiction from which it is effecting transactions into this state (i.e., one of the provinces or territories of Canada) and the Canadian broker-dealer must be a member of a self-regulatory organization or stock exchange in Canada. Again, this provision establishes the Canadian nexus (and regulatory control) necessary for a broker-dealer effecting transactions under this exemption.

Subsection (d) imposes a similar requirement on an agent representing a Canadian broker-dealer as is imposed on the broker-dealer under subsection (c).

Subsection (e) imposes additional requirements on a Canadian broker-dealer relying on the proposed exemption by requiring it to maintain its Canadian registration and membership in good standing, notifying the Canadian broker-dealer that it is obligated to provide books and records relating to its business in California as a broker-dealer when requested to do so by the Commissioner, and disclosing to its clients in this state that it is operating under an exemption from licensure in this state.

These provisions are necessary for regulatory, investigative and enforcement concerns under the Law and to notify the Canadian broker-dealers and client that the broker-dealer is subject to Canadian law and regulation with respect to these transactions, as well as subject to the Law.

Subsection (f) provides a similar, although limited, requirement with respect to an agent of a Canadian broker-dealer effecting transactions in reliance upon the proposed exemption.

Subsection (g) sets forth the parameters under which a Canadian broker-dealer or agent may effect transactions in securities upon reliance of the proposed exemption. These provisions are necessary to circumscribe and define the limited nature of the exemption from licensure under the Law.

Subsection (h) sets forth those conditions upon which a Canadian broker-dealer or agent will not be able to rely on the exemption under the proposed rule. These conditions are consistent with the provisions of the Law relating to those broker-dealers and agents who will be subject to disciplinary action under the Law and are necessary in the public interest to maintain the integrity of the exemption and for the protection of the Canadian investors resident in this state.

Subsection (i) is an additional prohibition upon reliance of the proposed exemption in the case of a criminal action being taken against a Canadian broker-dealer or agent of a Canadian broker-dealer, or with respect to any finding or sanction imposed on a Canadian broker-dealer or agent of a Canadian broker-dealer as a result of any self-regulatory or regulatory action, involving fraud, theft, deceit or misrepresentation or similar conduct involving moral turpitude. Again, this provision is necessary to satisfy the public policy condition expressed by Section 25204 of the Law.

Proposed Rule 260.204.11. The purpose of this exemption from the certification requirement of Section 25210 of the Law is to provide an exemption from licensure for a person who is a member of the Pacific Exchange, Inc. when engaged in the securities business solely as a specialist, market maker or floor broker on that securities exchange. This exemption is necessary in order to recognize that these broker-dealers engaging in limited transactions on the Pacific Exchange, Inc. are similar to broker-dealers engaging in similar transactions on other national securities exchanges, but for the fact that the Pacific Exchange, Inc. is located in California these individuals and firms are required to be licensed under the Law. These persons are engaged in the securities business solely as broker-dealers effecting transactions on behalf of other broker-dealers and are not effecting transactions on behalf of individual clients or customers. As a member of the Pacific Exchange, Inc., these persons are subject to regulation by the self-regulatory organization, which is itself subject to supervision and regulation by the SEC. Given the limited and restrictive nature of the securities business engaged in by these broker-dealers, no public purpose is served by requiring them to obtain a license under Section 25210. These broker-dealers remain subject to the anti-fraud provisions of the Law, however.

ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

FISCAL IMPACT

Cost to Local Agencies and School Districts required to be reimbursed under Part 7

(commencing with Section 17500) of Division 4 of the Government Code: None.

No other nondiscretionary cost or savings are imposed on local agencies.

DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

Facts evidence, documents, testimony, or other evidence upon which the agency relies to support a finding that the action will not have a significant adverse economic impact on business.

ADDENDUM REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period which ended on January 8, 2001. No public hearing was scheduled or heard.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

Ten comment letters were received during the public comment period. These comment letters are summarized below.

COMMENTOR 1: C.L. Potuznik of the Law firm of Dorsey & Whitney LLP on behalf of the Investment Dealers Association of Canada, letter dated November 17, 2000.

COMMENTS. The comments raised in this letter can be categorized into four main points: (1) extend to the exemption from qualification to be afforded by proposed Rule 260.105.40 beyond issuer transactions subject to Corporations Code Section 25110 to those reorganization, merger and non-issuer transactions subject to Sections 25120 and 25130; (2) extend the exemption from licensure for a Canadian broker-dealer to include transactions involving Canadian Retirement Accounts where the holder is not a Canadian resident; (3) clarify that the exemption from licensure for a Canadian broker-dealer proposed by Rule 260.204.10 does not restrict the use of other exemptions by Canadian broker-dealers; and (4) delete the “bad boy” prohibitions on the reliance of the proposed exemption from licensure for a Canadian broker-dealer who has a disciplinary history.

COMMENTOR 2: John Mountain of the Investment Funds Institute of Canada, letter dated November 24, 2000.

COMMENTS. The comment contained in this letter supports the adoption of the rules as proposed.

COMMENTOR 3. D.G. Waddell, Minister (Economic) and Deputy Head of Mission, of the Canadian Embassy, letter dated November 29, 2000.

COMMENTS. The gist of the letter from the Canadian Embassy is that the Department should give full consideration of the suggestions of the Investment Dealers Association of Canada, as set forth, above, in the November 17, 2000 letter from Mr. Potuznik; specifically, to amend the proposed rules to

provide a securities registration exemption for securities offered and sold to Canadian residents in Canadian self-directed tax-advantaged retirement plans and to rely upon Canadian regulators to maintain standards of integrity among Canadian broker-dealers.

COMMENTOR 4: Stephen Auerback of KingsGate Securities Limited, letter dated December 5, 2000.

COMMENTS. The comments made by this letter support the specific comments made in the November 17, 2000 letter, above, of Mr. Potuznik on behalf of the Investment Dealer Association of Canada.

COMMENTOR 5. James Werry of ScotiaMcLeod, letter dated December 15, 2000.

COMMENTS. The comments made by this letter support the specific comments made in the November 17, 2000 letter, above, by Mr. Potuznik on behalf of the Investment Dealers Association of Canada.

COMMENTOR 6. Barbara Muir of BMO Nesbitt Burns, letter dated December 15, 2000.

COMMENTS. The comments made by this letter support the specific comments made in the November 17, 2000 letter, above, by Mr. Potuznik on behalf of the Investment Dealers Association of Canada.

COMMENTOR 7. Adrienne R. Salvail-Lopez, Commissioner of the British Columbia Securities Commission, letter dated December 15, 2000.

COMMENTS. In general, the comments made in this letter support the specific comments made in the November 17, 2000 letter, above, by Mr. Potuznik on behalf of the Investment Dealers Association of Canada. Additionally, this letter also urges that the prohibition on the reliance on the exemption by Canadian broker-dealers with a disciplinary history be deleted in its entirety because the rule is not consistent with the proposed rule developed by the North American Securities Administrators Association, which does not contain such a blanket prohibition. Finally, the letter recommends that the language of proposed Rule 260.204.10(c) be expanded, if it is not already broad enough, to include the Mutual Fund Dealers Association of Canada and the *Bureau des services financiers* in Quebec, Canada within the term “self-regulatory organization”.

COMMENTOR 8. Bradley Doney, First Vice President and General Counsel, Merrill Lynch Canada Inc, letter dated January 4, 2001.

COMMENTS. This is another letter in support, and reiterates the comments, of Mr. Potuznik in his November 17, 2000 letter on behalf of the Investment Dealers Association of Canada.

COMMENTOR 9. C.L. Potuznik of the Law firm of Dorsey & Whitney LLP on behalf of the Investment Dealers Association of Canada, letter dated January 4, 2001.

COMMENTS. This letter confirms the changes to the proposed rule worked-out between the Department of Corporations and Mr. Potuznik on behalf the Investment Dealers Association of Canada; specifically, each of the concerns raised by his November 17th letter were addressed by the Department and resolved to the satisfaction of the Investment Dealers Association of Canada. Of particular note, is the agreement by the Investment Dealers Association of Canada that California's desire to impose a "bad boy" prohibition on the use of the exemption. The Department worked with the interested parties to fashion a mutual acceptable prohibition.

Additionally, the separate and distinct comment of the Commissioner of the British Columbia Securities Commission dealing with the broadness of the language of proposed subsection (c) of Rule 260.204.10 to encompass the Mutual Fund Dealers Association of Canada and the *Bureau des services financiers* in Quebec, Canada has been addressed. The proposed language is broad enough to include the proposed Mutual Fund Dealers Association of Canada. The proposed rule was amended to specifically include the *Bureau*.

COMMENTOR 10. Miriam Kagan, Counsel, Sun Life Assurance Company of Canada on behalf of Sun Life Securities Inc., letter dated January 8, 2001.

COMMENTS. The comments contained in these letter supports the specific comments made in the November 17, 2000, letter of Mr. Potuznik on behalf of the Investment Dealers Association of Canada.

RESPONSE TO COMMENTS

The Department addressed all of the comments of the interested parties through the complete revision of the proposed rule and the subsequent re-noticing for 15-day public comment dated February 13, 2001. A subsequent notice for 15-day public comment to correct a typographical error was sent on February 13, 2001. The Department revised the proposed rule as noted in the January 4, 2001 letter of Mr. Potuznik on behalf of the Investment Dealers Association of Canada and revised the proposed rule to address the separate comment of the Commissioner of the British Columbia Securities Commission.

No other comments were received.